

**BEFORE**  
**THE PUBLIC SERVICE COMMISSION**  
**OF SOUTH CAROLINA**

**DOCKET NO. 2004- 357 -W/S - ORDER NO. 2005-\_\_\_\_\_**

**JUNE \_\_\_\_\_, 2005**

IN RE: Application of Carolina Water	)	
Service, Inc. for adjustment of rates	)	<b>OFFICE OF REGULATORY</b>
and charges and modification of	)	<b>STAFF'S PROPOSED ORDER</b>
certain terms and conditions for the	)	<b>ON APPLICATION OF RATES</b>
provision of water and sewer	)	<b>AND CHARGES</b>
services.	)	
_____	)	

**INTRODUCTION**

This matter comes before the Public Service Commission of South Carolina ("Commission") on an application for increases in water and sewer rates and charges filed by Carolina Water Service, Inc. ("CWS" or "Company"). CWS's application was accepted by the Commission pursuant to S.C. Code Ann. § 5-5-210 *et. seq.* and 26 S.C. Code Regs. 103-512. The Company's application was filed on December 17, 2004.

By correspondence, the Commission instructed CWS to publish a prepared Notice of Filing, one time, in a newspaper of general circulation in the areas affected by the Company's application. The Notice of Filing indicated the nature of the application and advised all interested persons desiring to participate in the scheduled proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings. In the same correspondence, the Commission also instructed CWS to notify each customer affected by the application by mailing each customer a copy of the Notice of Filing. CWS furnished the Commission with

eight Affidavits of Publication demonstrating that the Notice of Filing had been duly published and mailed to each customer.

In response to the Notice of Filing, the Department of Health and Environmental Control (“DHEC”) and Midlands Utility, Inc., (“Midlands”) filed Petitions to Intervene in this matter.<sup>1</sup>

ORS requested that the Commission hold a night hearing in Dorchester County to afford members of the public a convenient forum to express their views and concerns about the pending application of CWS for increased water and sewer rates. ORS requested that the Commission also hold night hearings in the Midlands area and in York County. John Gibbons, Mayor of Irmo, requested that a night hearing be held in the Town of Irmo.

Night hearings in this matter were held on April 18, 2005, in Summerville, South Carolina; on April 20, 2005, in Irmo; on April 26, 2005, in Lake Wylie; and on May 2, 2005, in Lexington. Members of the public were allowed to testify at the night hearings.

On May 4, 2005, at 10:30 a.m., and reconvening on May 5, 2005, a public hearing concerning the matters asserted in CWS’s application was held in the Commission’s hearing room located at Synergy Business Park, 101 Executive Center Drive, Saluda Building, Columbia, SC. The full Commission, with Chairman Randy Mitchell presiding, heard the matter of CWS’s application. John Hoefer, Esquire, represented CWS. Florence Belser, Esquire, and Lessie Hammonds, Esquire, represented ORS. Charles Cook, Esquire represented Midlands, a South Carolina certificated public utility and bulk water customer of CWS. Jessica King, Esquire, represented the Department of Health and Environmental Control. Charles Terreni, Esquire, served as legal counsel to the Commission.

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<sup>1</sup> DHEC also filed a Motion to Expand the Scope of the Hearing at the time of filing the Petition to Intervene. The disposition of the Motion is addressed in the “Procedural Matters” portion of this Order.

CWS presented the testimony of Steven M. Lubertozi, Vice President of Regulatory Matters for CWS; Bruce T. Haas, S.C. Regional Director of Operations for CWS; and Pauline M. Ahern, CRRA, Vice President of AUS Consultants. The Office of Regulatory Staff presented testimony of Sharon G. Scott, ORS Auditor; Dawn M. Hipp, Program Specialist for ORS Water/Wastewater Department; Willie J. Morgan, Program Manager for ORS Water/Wastewater Department; and Dr. Ben Johnson, Consulting Economist and President of Ben Johnson Associates, Inc. DHEC proffered testimony of Jeffrey P. deBessonnet, Director of DHEC's domestic wastewater permitting program.<sup>2</sup>

### **PROCEDURAL MATTERS**

On March 3, 2005, DHEC filed its Petition to Intervene and a Motion to Expand the Scope of the Hearing. By Order No. 2005-113, the Commission granted the Petition but denied the Motion.

The Petition to Intervene filed on behalf of Midlands was granted.

On April 26, 2005, CWS filed a Motion to Strike regarding any testimony of witnesses complaining of a sewer back-up. This Commission held said Motion in abeyance.

Midlands and CWS entered into a Stipulation and moved to have the Stipulation entered into the evidence of the case. The Stipulation provided for an increase of bulk rate charges from \$11 to \$15 per month for the treatment charges for bulk wastewater treatment provided by CWS

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<sup>2</sup> DHEC pre-filed testimony of Jeffrey P. deBessonnet with the Commission on April 21, 2005. On April 25, 2005, CWS filed a Motion for Order Prohibiting Introduction or Admission of Testimony based on the untimely filing of deBessonnet's pre-filed testimony and that the testimony pertains to matters beyond the scope of the hearing. In Order No. 2005-219, the Commission granted CWS's Motion based on the testimony being beyond the scope of the hearing, but allowed DHEC to make an offer of proof regarding deBessonnet's testimony. In addition, the Commission allowed CWS to proffer conditional rebuttal testimony of Steven M. Lubertozi in response to deBessonnet's testimony.

to Midlands. The parties further stipulated that their respective witnesses' testimony would be entered into the evidence of the case. *See* Hearing Exhibit 7.

Subsequent to DHEC proffering deBessonnet's testimony and Midlands entering the stipulation with CWS into the record, DHEC and Midlands moved to be excused from the remainder of the hearing but to remain as parties of the case. The Commission granted the motions and allowed both parties to be excused with no objections from CWS or ORS.

### **BACKGROUND**

CWS is a wholly owned subsidiary of Utilities, Inc. and is a public utility within the meaning of S.C. Code Ann. § 58-5-10(3) (Supp.2004). The Company furnishes water and/or sewer services to approximately 15,500 residential and commercial customers in South Carolina. CWS provides water service by deep drilled wells or through the purchase and resale of bulk water. The Company provides sewer service through its wastewater collection, transportation and treatment facilities in addition to collection-only service through wholesale wastewater treatment providers.

The Company's currently authorized rates and charges were approved by Order No. 2001-887, issued on August 27, 2001, in Docket No. 2000-207-W/S.

ORS made on-site investigations of the Company's facilities, audited the Company's books and records, and gathered other detailed information concerning the Company's operations.

### **FINDINGS OF FACT AND SUPPORTING EVIDENCE**

Based upon the Application, the testimony and exhibits received into evidence at the hearings, and the entire record of these proceedings, the Commission now makes the following findings of fact:

1. CWS is a water and sewer utility providing water and sewer service in its assigned service areas within South Carolina, and its operations in South Carolina are subject to the jurisdiction of the Commission, pursuant to S.C. Code Ann. § 58-5-10, *et seq.* (1976 as amended).

The evidence to support this finding is contained in the application filed by CWS, in the testimony of CWS's witnesses, Mr. Bruce Haas and Mr. Steven Lubertozi, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. By filing its application, CWS admits that it is a public utility within the meaning of S.C. Code Ann. § 58-5-10(3) (Supp.2004) and submits itself to the jurisdiction of the Commission.

2. The appropriate test year period for the purposes of this proceeding is the twelve month period ending June 30, 2004.

CWS filed its application on December 17, 2004, and chose the test year ending June 30, 2004. ORS conducted its audit based on that test year. No party contested the use of the test year proposed by CWS. The test year is established to provide a basis for making the most accurate forecast of the utility's rate base, reserves, and expenses in the near future when the prescribed rates are in effect. *Porter v. South Carolina Public Service Commission*, 328 S.C. 222, 493 S.E.2d 92 (1997), citing *Hamm v. S.C. Pub. Serv. Comm'n*, 309 S.C. 282, 422 S.E.2d 110 (1992). While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable changes outside the test year in expenses, revenues, and investments. The Commission will also consider adjustments for any unusual situations which occurred in the test year. Where an unusual situation exists which shows that the test year figures are atypical, the

Commission should adjust the test year data. *See Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E.2d 278 (1978); *see also, Parker v. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984), *citing City of Pittsburgh v. Pennsylvania Public Utility Commission*, 1887 P.A. Super. 341, 144 A.2d 648 (1958); *Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E.2d 278 (1978). Based on the information available to the Commission, the Commission finds that the test year ending June 30, 2004, is appropriate for the purposes of this rate request.

3. The Commission will use rate of return on rate base as a guide in determining the lawfulness of CWS's rates and the fixing of just and reasonable rates.

As per the Company's Application, given its substantial plant investment, and specifically its rate base reflected on Schedule C of Exhibit "B" of its Application, CWS is entitled to have the reasonableness of its proposed rates determined in accordance with the rate of return on rate base methodology. Application, P. 4, ¶ 12. "The Public Service Commission has wide latitude to determine an appropriate rate-setting methodology." *Heater of Seabrook v. Public Serv. Comm'n of South Carolina*, 324 S.C. 56, 64, 478 S.E.2d 826, 830 (1996). S.C. Code Ann. § 58-5-240(H) (Supp.2004) directs the Commission to specify an allowable operating margin in all water and wastewater orders. However, "that directive does not mean that the operating margin methodology must be used in determining a fair rate of return." *Id.* Operating margin "is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary equity and debt capital that a larger utility needs for sound operation." *Id.* No party contested CWS's request for rate base treatment. Due to CWS's large rate base and its need to earn a fair and reasonable return on its investment, the Commission

finds that return on rate base methodology is the appropriate rate-setting methodology to use in this case.

4. The determination of return on rate base requires three components. These three components are capital structure, cost of equity (or return on equity), and the cost of debt.

Both rate of return witnesses, Ahern and Johnson, identified the three components necessary to determine the return on rate base as capital structure, cost of equity (or return on equity), and the cost of debt. “For regulatory purposes, the rate of return is the amount of money earned by a public utility, over and above operating costs, expressed as a percentage of the rate base. In other words, the rate of return includes interest on long-term debt, dividends on preferred stock and earnings on common stock (including surplus or retained earnings).” Charles F. Phillips, Jr., *The Regulation of Public Utilities*, (1993) at 376. Additionally, “the return is that money earned from operations which is available for distribution among the various classes of contributors of money capital.” *Id.*

5. In the return on rate base determination, it is appropriate to use the capital structure and cost of debt of CWS’s parent company, Utilities, Inc. The capital structure for Utilities, Inc. at December 31, 2003, was 59.23% debt and 40.77% common equity at a debt cost rate of 7.28%. CWS’s capital structure was imputed from Utilities, Inc.’s capital structure; therefore, CWS used Utilities, Inc.’s December 31, 2003, capital structure for CWS’s June 30, 2004 test year.

Witnesses Ahern and Johnson used the capital structure and cost of debt of Utilities, Inc. Use of the cost of debt for Utilities, Inc. is appropriate as the parent company provides all external financing for CWS and determines how much income CWS will retain. CWS stated in

its Application that the capital structure for Utilities, Inc. was 59.23% debt to 40.77% equity and a 7.28% cost of debt. No party opposed the use of these percentages.

6. The return on equity percentage range provided by ORS witness Dr. Johnson, 9.5% to 10.8%, is used for purposes of determining a fair return on equity for the Company.

Evidence concerning a fair return on equity was provided by Ahern and Johnson. The Commission adopts the testimony of Dr. Ben Johnson to establish a fair return on equity for CWS. To determine the estimate of the cost of equity, Dr. Johnson performed two separate analyses – the Comparable Earnings Approach and the Market Approach. Dr. Johnson estimated the Company's cost of equity using the Comparable Earnings Approach to be in the range of 10.1% to 11.1%. In Dr. Johnson's market analysis, two analytic processes involving data from the financial markets were used. Dr. Johnson observed historic market returns earned by equity investors and prepared a Discounted Cash Flow (DCF) analysis. Under his market analysis, Dr. Johnson concluded the cost of equity of CWS to be in the range of 9.5% - 10.8%. Dr. Johnson included in his analysis a 0.4% upward adjustment to cover the cost of issuing stock and an upward adjustment of 0.6% to account for the relatively small size of the Company's service territory in South Carolina. The Commission finds that the range derived from Dr. Johnson's Market Approach is the appropriate range to consider in this case.

7. The Company's quality of service is a factor this Commission can consider in determining a fair and reasonable rate of return.

It is clear from the evidence in this case that quality of service should be a factor when determining the Company's rate of return. Dr. Johnson testified that it is appropriate for this Commission to consider a company's quality of service issues when calculating a rate of return.



I think it certainly can be a significant consideration by the Commission in its order. In fact, one of the ways commissions in this country often do take into account either deficiencies in quality of service, or poor management, or extraordinary good management, when they want to either reward a company because they believe they've been unusually effective in cutting costs or running a company efficiently, or if they're concerned that they don't have the level of consumer satisfaction of the average utility.

One of the ways commissions have historically done that is to allow a profit rate of return that's within the cost of capital range, but at one end or the other, either the high or the low. In that sense I think it's highly relevant. Tr. p. 275, l. 21 – p. 276, l. 16.

ORS witness Dawn Hipp also testified in support of considering quality of service.

It is my opinion that when you're selecting the range for rate, rate of return on equity, and you're provided a range, that quality of service could be used as a determining factor in choosing the appropriate range or percentage in that range. Tr. p. 427, l. 21.

CWS witness Haas also testified that quality of service is a proper consideration of the Commission when determining a company's request for rate increase. Tr. p. 207, l. 14.

Furthermore, case law supports this finding. "...The quality of service rendered is, necessarily, a factor to be considered in fixing the 'just and reasonable' rate therefore." *Patton v. Public Service Comm'n*, 280 S.C. 288, 312 S.E.2d 257 (1984) citing, *State Ex rel. Util. Com'n v. General Tel. Co.*, 285 N.C. 671, 208 S.E.2d 681 (1974).

8. The low end of the range from Dr. Johnson's Market Approach should be considered in determining a fair return on equity due to the significant quality of service issues of CWS.

Several witnesses at the night hearings and the May 4 day hearing complained of poor quality of service on the part of CWS. A public witness testified that an incident occurred in which sewage was in the roads and backyards of CWS's service areas. She also testified to the

obnoxious odor caused by the sewage. Several witnesses testified that they could not drink the water provided by CWS. One public witness stated that the water looked like “soot” when it settled.

A witness testified that the nursery in his church had a bad odor because sewage backs up due to the low water pressure. Other witnesses testified about problems with sewer back ups. There was also testimony that a nearby playground could not be used by children because the stench was so strong from CWS’s treatment plant.

Several witnesses testified to the non-responsiveness of CWS’s customer service. The terms “arrogant” and “arrogance” were used repeatedly by customers to describe the attitude of CWS’s customer service representatives and other personnel. One witness stated that no member of CWS’s management would meet with him to discuss his issues with CWS.

Based upon testimony given at all of the night hearings and the day hearing, this Commission finds that CWS has quality of service issues that the Company needs to address. Therefore, the low range of Dr. Johnson’s Market Approach should be considered when determining an appropriate rate for CWS’s cost of equity.

9. This Commission finds that the 0.4% stock issuance adjustment included in Dr. Johnson’s testimony should not be allowed.

The stock issuance adjustment made by Dr. Johnson is not allowed based on witness Ahern’s testimony. When asked why Ahern did not include a stock issuance adjustment in her cost of equity testimony, Ahern stated she did not include the adjustment because CWS, to the best of her knowledge, does not intend to issue stock nor has it recently issued stock. Tr. p. 217, l. 15 – p. 218, l.2.

No evidence exists that CWS intends to issue stock or has recently issued stock. Therefore, this Commission finds that an adjustment to cover the cost of issuing stock is not supported by the evidence of this case, and therefore, the 0.4% stock issuance adjustment included in Dr. Johnson's analysis should be excluded.

In *Hamm v. South Carolina Public Service Commission*, 309 S.C. 282, 422 S.E.2d 110 (1992), the Supreme Court reversed a decision by the Commission where the Commission set a rate of return on common equity including financing costs and "market breaks" adjustments, which are both adjustments tied to projected new stock issues, and where there was no evidence in the record of an intention to issue common stock in the near future. Because there is no evidence that CWS intends to issue stock in the near future, no stock issuance adjustment should be allowed in the cost of equity in the present case.

10. This Commission finds that the 0.6% size of company adjustment included in Dr. Johnson's testimony should not be allowed.

CWS is the largest privately owned water and sewer company in South Carolina. Based upon annual reports filed with the Commission, CWS has the largest number of customers of any privately owned water or sewer utility operating in South Carolina, and CWS has the highest amount of revenue of any privately owned water and sewer company in the state based on its 2004 annual report.<sup>3</sup> Therefore, this Commission finds that the 0.6% small company adjustment should be excluded.

11. A fair return on equity for CWS is 8.5%.

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<sup>3</sup> Pursuant to Rule 201, SCRE, this Commission takes judicial notice of CWS's annual reports and all filings that reflect the size of CWS and Utilities, Inc.

The Commission derived an 8.5% return on equity by using the low end of Dr. Johnson's range, 9.5%, and subtracting 0.4% to remove the stock adjustment included by Dr. Johnson and subtracting 0.6% to remove the small company adjustment included by Dr. Johnson and which this Commission has determined should be excluded.

12. Using the capital structure of Utilities, Inc. at December 31, 2003, as imputed to CWS's June 30, 2004, test year of 59.23% debt and 40.77% common equity at a debt cost rate of 7.28% and a return on equity of 8.5% produces a rate of return on rate base of 7.78%.

The return on rate base is determined by using long-term debt, equity, cost of debt and return on equity. When using the capital structure of Utilities, Inc. at December 31, 2003, of 59.23% debt and 40.77% equity, a cost of debt of Utilities, Inc. at December 31, 2003, of 7.28% and a return on equity of 8.5%, the appropriate rate of return on rate base for CWS is 7.78%. The following table indicates the capital structure of the Company at the June 30, 2004, test year, the cost of debt, the cost of equity as approved in this Order, and the resulting rate of return on rate base:

TABLE A

	RATIO	EMBEDDED COST	OVERALL COST
Long-term Debt	59.23%	7.28%	4.31%
Common Equity	<u>40.77%</u>	<u>8.50%</u>	<u>3.47%</u>
TOTAL	<u>100.00%</u>		<u>7.78%</u>

13. By its Application, CWS is seeking an increase in its rates and charges for water and sewer service which results in \$1,815,528 of additional revenues to CWS.

The evidence for the finding concerning the amount of the requested rate increase is contained in the Application filed by CWS and in the testimony and exhibits of ORS witness

Sharon Scott. The Application of CWS indicates that it is seeking additional revenues of \$180,854 from water operations and additional revenues of \$1,634,674 from sewer operations, totaling \$1,815,528. Application of CWS, Schedule B, p. 1 of 4. Additionally, Scott testified that under the rates proposed in the Application, CWS would see an increase in revenues of \$1,815,528. Therefore, the Commission finds that CWS is seeking an increase in its revenues of \$1,815,528.

14. The Commission finds that the accounting adjustments made by ORS are appropriate and are accepted.

CWS consented to ORS's accounting adjustments, and DHEC and Midlands did not oppose the adjustments. Therefore, this Commission adopts the accounting adjustments as proposed by ORS.

15. The appropriate operating revenues for CWS for the test year under present rates and after accounting and pro forma adjustments are \$5,674,555.

Following ORS's audit of CWS's books and records, ORS's determination of the Company's operating revenues equaled \$5,674,555. CWS agreed with the amount of operating revenues proposed by ORS. Since this issue was not contested, we find that the operating revenues submitted by ORS are adopted.

16. The appropriate operating expenses for CWS for the test year under present rates and after pro forma adjustments and adjustments for known and measurable occurrences outside the test year are \$5,276,647.

Following ORS's audit of CWS's books and records, ORS's determination of the Company's operating expenses equaled \$5,276,647. CWS consented to the amount of operating

expenses proposed by ORS. Since this issue was not contested, we find that the operating expenses submitted by ORS are reasonable and are adopted.

17. The appropriate rate base for CWS for the test year after accounting and pro forma adjustments and adjustments for known and measurable occurrences outside the test year is \$14,940,867.

Based on ORS's audit of the Company, ORS determined that CWS's rate base including known and measurable occurrences outside the test year equaled \$14,940,867. CWS agreed with the amount of rate base proposed by ORS; therefore, we find that ORS's proposal is appropriate and is adopted. The following table illustrates the calculations for CWS's rate base:

TABLE B

Gross Plant in Service	\$36,704,218
LESS: Accumulated Depreciation	<u>(4,781,663)</u>
Net Plant in Service	31,922,555
ADD: Cash Working Capital	521,361
Water Service Corp. – Rate Base	127,824
DEDUCT: Advances in Aid of Construction	(1,600)
Contributions in Aid of Construction	(15,195,347)
Plant Acquisition Adjustment	(482,719)
Accumulated Deferred Income Taxes	(1,522,090)
Customer Deposits	<u>(429,117)</u>
TOTAL YEAR END RATE BASE	<u>\$14,940,867</u>

18. The income requirement for CWS, using the return on rate base of 7.78% found appropriate in this Order and the adjusted rate base of \$14,940,867, is \$1,162,010.

Under rate of return on rate base regulation, the Commission must approve an income requirement that will permit the Company to recover operating costs and provide an opportunity to earn the approved rate of return on the rate base. The determination of the income requirement requires a calculation using approved Operating Revenues and approved Operating

Expenses to determine Total Operating Income. Total Operating Income is then increased for approved Customer Growth resulting in Net Income for Return. The following table illustrates the calculations for CWS's Net Income for Return:

TABLE C

	<u>After Increase</u>
Operating Revenues	\$6,725,762
Operating Expenses	<u>5,580,693</u>
Total Operating Income	1,145,069
Customer Growth	<u>16,941</u>
NET INCOME FOR RETURN	<u>\$1,162,010</u>
Return on Rate Base	<u>7.78%</u>

19. In order for CWS to have the opportunity to earn its income requirement of \$1,162,010, CWS must be allowed additional revenues totaling \$1,059,453.

20. The rates and charges contained in Appendix A, attached to this Order and incorporated herein by reference, are the appropriate rates for CWS to charge and should allow CWS the opportunity to earn the return on rate base approved in this Order.

Upon determination of the revenue requirements for a utility in a ratemaking proceeding, the next step is the determination of the specific rates or rate structure that will yield the required revenues. A generally accepted principle is that proper utility regulation requires the exercise of control over a utility's rate structure.

In designing rates for CWS, the Commission strives to set rates that are "just and reasonable" and without undue discrimination. In the case before the Commission, CWS has requested rates for the base facility charge for water service that result in a uniform water base facility charge. The Commission finds that such a uniform rate schedule is fair and reasonable and is in the best interests of the customers and CWS.

21. The appropriate operating margin for CWS based upon the herein approved adjustments and rates is 7.70%.

S.C. Code Ann. § 58-5-240(H) (Supp.2004) provides, in part, that “[t]he [C]ommission shall specify an allowable operating margin in all water and wastewater orders.” Based upon the rate of return on rate base approved herein and the revenues and expenses also approved herein, the corresponding operating margin is calculated to be 7.70%. The following Table reflects an operating margin of 7.70%:

TABLE D

	<u>After Increase</u>
Operating Revenues	\$6,725,762
Operating Expenses	<u>(5,580,693)</u>
Total Operating Income	1,145,069
Customer Growth	<u>16,941</u>
TOTAL INCOME FOR RETURN	<u>\$ 1,162,010</u>
Operating Margin (After Interest Expense of \$644,242)	<u>7.70%</u>

22. The Stipulation between Midlands and CWS providing a monthly rate of \$15 for bulk wastewater treatment is an appropriate agreement. Therefore, this Commission finds that the Stipulation shall govern the rates charged by CWS to Midlands for bulk wastewater treatment.

23. The Company’s request to modify terms and conditions of CWS’s rate schedule relating to tenant billing is appropriate.

CWS requested to modify its rate schedule provisions pertaining to service provided to rental units. The proposed modification is intended to bring CWS’s rate schedule into compliance with a recent amendment to statutory law. *See*, 2003 S.C. Acts No. 63 § 1,



amending S.C. Code Ann. § 27-33-50 and effective June 25, 2003. ORS supported CWS's proposed modification to terms and conditions listed in the Company's proposed tariff.

24. The Company's request to add terms and conditions of CWS's water rate schedule relating to cross-connection testing is appropriate.

The proposed language provides notice to customers that any cross-connections must be addressed by an approved backflow prevention device and that the customer is responsible for the annual inspection. If the customer does not comply, the proposed language gives notice to the customer that CWS can arrange for an inspection and bill the customer for the inspection without markup. ORS supported the Company's proposed language requiring CWS's water customers to conduct cross-connection testing pursuant to state law. *See*, 24A S.C. Code Ann. Regs. R. 61-58-7.F.8.

25. It is in the public interest to require a performance bond in the amount of \$700,000 for the Company.

The Commission's regulations state bond amounts must range from an amount not less than \$100,000 and not more than \$350,000. The bond amount is also set forth in S.C. Code Ann. § 58-5-720 (Supp. 2004). ORS witness Dawn Hipp testified that the bond requirement for CWS should be increased to \$350,000 for water operations and \$350,000 for sewer operations based on expenses from the test year. Therefore, this Commission finds that in order to provide sufficient financial assurance to both the customer and the Commission in the event that the Company fails to provide safe and adequate service, a bond in the amount of \$700,000 is required.

### **CONCLUSIONS OF LAW**

Based upon the Findings of Fact as contained herein and the record of the instant proceeding, the Commission makes the following Conclusions of Law:

1. Rate of return on rate base is the appropriate guide in determining the lawfulness of the rates of CWS and in fixing of just and reasonable rates for CWS to charge its customers in South Carolina.

2. A fair rate of return on rate base for the operation of CWS in South Carolina is 7.78%. This rate of return is calculated using a capital structure of 59.23% debt and 40.77% equity, a cost of debt of 7.28%, and a return on equity of 8.5%. Based on the discussion and analysis of the Commission as detailed in this Order, these components of capital structure, cost of debt, and cost of equity and the resulting rate of return on rate base produce a fair and reasonable rate of return which the company should have the opportunity to earn.

3. For the test year of June 30, 2004, the appropriate operating revenues, under present rates and as adjusted in this Order, are \$5,674,555, and the appropriate operating expenses, under present rates and as adjusted in this Order, are \$5,276,647.

4. Using the rate base as adjusted in this Order of \$14,940,867 and the return on rate base of 7.78% found to be fair and reasonable in this Order, the income requirement for CWS is \$1,162,010.

5. In order for CWS to have an opportunity to earn the return on rate base found reasonable and approved in this Order and to meet the income requirement, CWS must be allowed additional revenues of \$1,059,453.

6. The rates approved in this Order are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of the Company.

7. Based on the adjustments approved herein and the increase in rates approved herein, the appropriate operating margin for CWS on its South Carolina operations is 7.70%.

8. The appropriate bond requirement for the Company is \$700,000.

IT IS THEREFORE ORDERED THAT:

1. CWS is granted a rate of return on rate base for its water and sewer operations in South Carolina of 7.78%.

2. The schedule of rates and charges attached hereto as Appendix A are hereby approved for service rendered on or after the date of this Order. Further, the schedules are deemed to be filed with the Commission pursuant to S.C. Code Ann. § 58-5-240 (Supp.2004).

3. Should the schedules approved herein and attached hereto as Appendix A not be placed in effect until three (3) months from the effective date of this Order, the schedules shall not be charged without written permission from the Commission.

4. CWS shall maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Class A Water and Sewer Utilities, as adopted by this Commission.

5. CWS shall post, with this Commission, a bond with a face value of \$700,000 to satisfy the findings in this Order within ninety (90) days of receipt of this Order.

6. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

\_\_\_\_\_  
Chairman

ATTEST:

\_\_\_\_\_  
Executive Director  
(SEAL)